



**DEPARTMENT OF TRANSPORTATION**

**[4910-22-P]**

**Federal Highway Administration**

**[FHWA Docket No. FHWA-2017-0023]**

**Proposed Guidance on Safe Harbor Rate Streamlining for Engineering and Design Services Consultant Contracts**

**AGENCY:** Federal Highway Administration (FHWA), U.S. Department of Transportation (DOT).

**ACTION:** Notice; request for comment.

**SUMMARY:** The FHWA is soliciting comments regarding proposed guidance on implementation of a Safe Harbor indirect cost rate for certain engineering design service firms that find establishing such rates to be costly and a barrier to participating in engineering and design service contracts reimbursed with Federal-aid Highway Program (FAHP) Funds. The FHWA seeks comment on its proposed implementation of a Safe Harbor indirect cost rate and its intention to notify all contracting agencies receiving FAHP funds that an agency-developed Safe Harbor indirect cost rate for eligible consulting firms may be used as a component of a risk-based oversight process to provide reasonable assurance to FHWA that consultant costs on FAHP-funded contracts are allowable in accordance with the Federal regulations.

**DATE:** Comments must be received on or before [INSERT DATE 30 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]. Late-filed comments will be considered to the extent practicable.

**ADDRESSES:** Mail or hand deliver comments to the U.S. Department of Transportation, Dockets Management Facility, Room W12-140, 1200 New Jersey

Avenue, SE., Washington, DC 20590, or fax comments to (202) 493–2251.

Alternatively, comments may be submitted to the Federal eRulemaking portal at:

<http://www.regulations.gov>. All comments must include the docket number that appears

in the heading of this document. All comments received will be available for

examination and copying at the above address from 9 a.m. to 5 p.m., e.t., Monday

through Friday, except Federal holidays. Those desiring notifications of receipt of

comments must include a self-addressed, stamped postcard, or you may print the

acknowledgment page that appears after submitting comments electronically. Anyone

can search the electronic form of all comments in any one of our dockets by the name of

the individual submitting the comment (or signing the comment, if submitted on behalf of

an association, business, or labor union). Anyone may review DOT's complete Privacy

Act Statement in the Federal Register published on April 11, 2000 (Volume 65, Number

70, Pages 19477–78).

**FOR FURTHER INFORMATION CONTACT:** For questions about the program discussed herein, contact John McAvoy, Consultant Services Program Manager, FHWA Office of Program Administration, (202) 853-5593 or via e-mail at

[john.mcavoy@dot.gov](mailto:john.mcavoy@dot.gov). For legal questions, please contact Steve Rochlis, Office of the Chief Counsel, (202) 366–1395, or via e-mail at [steve.rochlis@dot.gov](mailto:steve.rochlis@dot.gov). Office hours are from 8:00 a.m. to 4:30 p.m., e.t., Monday through Friday, except Federal holidays.

**SUPPLEMENTARY INFORMATION:**

Electronic Access and Filing

You may submit or retrieve comments online through the Federal eRulemaking portal at: <http://www.regulations.gov>. The Web site is available 24 hours each day, 365 days each year. Please follow the instructions. Electronic submission and retrieval help and guidelines are available under the help section of the Web site. An electronic copy of this document may also be downloaded from the Office of the Federal Register's home page at: <http://www.archives.gov> and the U.S. Government Publishing Office's Web page at: <http://www.access.gpo.gov/nara>.

## **PURPOSE OF THIS NOTICE**

The FHWA is requesting comment on its proposed guidance for implementation of a Safe Harbor indirect cost rate and its intention to notify all contracting agencies receiving FAHP funds that an agency-developed Safe Harbor indirect cost rate for eligible consulting firms may be used as a component of a risk-based oversight process to provide reasonable assurance to FHWA that consultant costs on FAHP-funded contracts are allowable in accordance with the Federal regulations. Comments received through this notice will be considered by FHWA to assess implementation of a Safe Harbor indirect cost rate.

## **BACKGROUND**

Consulting firms and contractors providing services under a contract reimbursed with FAHP funds are required to account for, and bill, costs in accordance with the Federal cost principles of 48 CFR part 31. In addition, Federal law and regulations for the FAHP require contracting agencies to accept indirect cost rates developed in

accordance with the Federal cost principles and to apply those rates for the purposes of contract estimation, negotiation, administration, reporting, and contract payment (as specified in 23 U.S.C. 112(b)(2) and 23 CFR 172.7). As such, consulting firms providing engineering and design-related services to a contracting agency under a contract funded by the FAHP are required to develop indirect cost rates in accordance with the Federal cost principles on an annual basis. Similarly, contracting agencies must provide reasonable assurance that consulting firm costs claimed under FAHP-funded contracts, including both direct and indirect costs, are allowable in accordance with the Federal cost principles.

Adhering to these accounting requirements can place a significant burden on some consulting firms and may create a barrier for otherwise eligible and qualified firms to compete for FAHP-funded contracts. For example, small firms, including many Disadvantaged Business Enterprise firms, may lack the financial expertise to develop an indirect cost rate that would be acceptable to a cognizant Federal or State government agency, or lack the resources to hire a Certified Public Accountant (CPA) to conduct an audit to provide assurance as to the development of an indirect cost rate compliant with Federal requirements. Often, a CPA audit is cost-prohibitive given the size and scope of the federally funded contracts for which the firm could compete. In addition, new or start-up firms generally do not have a contract-related cost history to use as a base for development of an indirect cost rate. Other well-established firms may not have previous experience with federally funded contracts for which a compliant indirect cost rate could

be developed. Currently, these firms are prohibited from participating in FAHP-funded contracts without the development and application of a provisional indirect cost rate for the specific contract, which is adjusted based upon a contracting agency conducted final audit at the completion of the contract. Even the smallest final audit requires a significant commitment of contracting agency audit resources.

To remove these barriers for otherwise qualified consulting firms, and to enhance contracting agency oversight of compliance with Federal cost principles, in 2012, the FHWA developed the Safe Harbor Indirect Cost Rate Test and Evaluation pilot. Ten contracting agencies representing a diversity of location and size participated in the test. Eligible consulting firms with whom the contracting agencies do business have the option of applying a Safe Harbor indirect cost rate to contracts in instances where the firm does not have an established rate for the reasons stated above. The selected Safe Harbor indirect cost rate is significantly lower than the industry average rate, providing an incentive for firms to develop an actual rate, when able to do so and consistent with their cost experience, in accordance with the Federal cost principles as required in Federal law and regulation.

Test results have shown a reduction in the financial management barriers that prevented new, small, or disadvantaged but qualified consulting firms from entering the federally funded engineering services market, and creation of a framework for these consulting firms to establish a cognizant agency approved indirect cost rate. Contracting agencies report that 17 consulting firms have graduated from the program after

developing a cost history leading to an approved indirect cost rate. In addition, following a risk-based approach allows contracting agency oversight and audit resources to shift focus from those firms opting to apply a Safe Harbor indirect cost rate (which are generally employed on fewer contracts or on smaller contracts) to those firms with multiple, higher dollar contracts and more complex accounting structures.

The test and evaluation of the Safe Harbor indirect cost rate was conducted by the following contracting agencies and respective FHWA Division Offices: Alabama DOT, California Department of Transportation, Michigan DOT, Missouri DOT, North Carolina DOT, North Dakota DOT, Ohio DOT, South Carolina DOT, Texas DOT, and Washington State DOT. In these States, eligible consulting firms have the option of using a Safe Harbor indirect cost rate on contracts executed within the established test period. A consulting firm is considered eligible if it has not had an indirect cost rate previously accepted by a cognizant agency (i.e., a governmental agency that has performed or reviewed an audit in accordance with generally accepted government auditing standards (GAGAS) to test compliance with the requirements of the Federal cost principles (as specified in 48 CFR part 31) and issued an audit report of the consultant's indirect cost rate, as described in 23 CFR 172.3). Consulting firms with an audited, or otherwise accepted, actual indirect cost rate, developed in accordance with the Federal cost principles, are not considered eligible to participate in the Safe Harbor Program. Contracting agencies are given discretion to determine the eligibility of consulting firms

for a Safe Harbor indirect cost rate for use on a case-by-case basis and are required to document their decision.

Through collaboration with the test contracting agencies, FHWA's test and evaluation pilot used a nationwide Safe Harbor indirect cost rate of 110 percent of a firm's direct salary rate. The test contracting agencies agreed that this rate was conservative and significantly lower than the industry average of typically claimed indirect cost rates. As such, while still providing for reimbursement of a significant portion of basic overhead costs, the use of this conservative rate incentivized consulting firms to develop an actual indirect cost rate when able to do so. The Safe Harbor indirect cost rate also provided a minimal risk to contracting agencies for overpayment to those consulting firms participating in the program. Based on FHWA's experience with this pilot, FHWA is proposing to expand the use of the Safe Harbor indirect cost rate, beyond the 10 pilot States, to allow eligible consulting firms to use a State contracting agency-developed indirect cost rate.

A Safe Harbor indirect cost rate is not intended for use on field-based contracts involving field overhead rates. Other direct costs that are not considered to be included within the Safe Harbor Program include: travel costs (airfare, rental car, mileage, lodging, per diem, etc.), external printing and reproduction costs, mailing and shipping costs, equipment rental fees, sub-consultants, and other direct costs as appropriate to the contracted services.

A Safe Harbor indirect cost rate is applied to new contracts executed with a contracting agency, or subrecipient. Once applied to a contract, the Safe Harbor indirect cost rate should be used for the duration of the contract. It is not uncommon for new or start-up firms to show large fluctuations in an indirect cost rate in the initial years of operation, before contract workload normalizes. Using the Safe Harbor indirect cost rate for the duration of a contract provides cost certainty in estimating the total contract amount and helps reduce the risk of costly contract modifications, necessary due to a significant fluctuation of an indirect cost rate. Similarly, a Safe Harbor indirect cost rate may be used in the determination of the fixed fee portion of the contract, which would not be subject to adjustment unless warranted by changes to the scope of work or duration of the contract.

Eligible consulting firms that use the Safe Harbor indirect cost rate, and do not have established salaries or wage rates for employees or classes of employees, use negotiated, fixed hourly labor rates for the direct labor portion of the contracted services. The negotiated direct labor rate should meet the reasonableness provisions as set forth in 2 CFR 200.404, considering the nature of the services to be provided. Where appropriate for the scope of services under contract, a “fully loaded” hourly rate could be established utilizing a reasonable hourly direct labor rate, a Safe Harbor indirect cost rate as the overhead rate component, and an appropriate amount of fixed fee that considers the complexity and risk involved.



The Safe Harbor indirect cost rate is intended to be a component of a contracting agency's risk-based oversight process. Contracting agencies using the Safe Harbor indirect cost rate must first develop written risk-based oversight procedures designed to provide reasonable assurance of consultant compliance with the Federal cost principles in accordance with 23 CFR 172.11(c)(2). The use of the Safe Harbor indirect cost rate is voluntary for both the contracting agency and for eligible firms. In reviewing the eligibility of a consulting firm opting to use the Safe Harbor indirect cost rate, it may be necessary to contact the State department of transportation in the home State of the consulting firm to verify the audit history of the firm and ensure the firm does not have an audited or otherwise accepted indirect cost rate developed in accordance with the Federal cost principles. Use and application of the Safe Harbor indirect cost rate by eligible firms is one component of this risk-based oversight process. Some evaluation of the accounting system of the consulting firms choosing to use the Safe Harbor indirect cost rate may be necessary to verify the capability of accumulating and tracking direct labor for applying the Safe Harbor indirect cost rate, as well as for billing other direct costs by contract, segregating indirect costs, etc. The Internal Control Questionnaire provided in Appendix B of the *AASHTO Uniform Audit and Accounting Guide (2016 Edition)* may be used by contracting agencies as a tool for assessing the accounting system capabilities of firms opting to use the Safe Harbor indirect cost rate. A contracting agency may wish to conduct post contract audits or other evaluations to verify accurate accumulation and billing of direct contract costs. However, an audit of

indirect costs is not necessary for Safe Harbor indirect cost rate contracts, as the rate should be applied for the duration of the contract, and retroactive adjustments to indirect costs incurred on these contracts is not necessary.

If a contracting agency elects to use a Safe Harbor indirect cost rate program as an element of a risk-based oversight process in compliance with 23 CFR 172.11(c)(2), the agency shall prepare and maintain written policies and procedures establishing the program in accordance with 23 CFR 172.5(c)(10). In conjunction with the development of written risk-based oversight procedures, the contracting agency should consider any actions necessary to comply with State regulation, policy, and/or procedures, as well as any revisions needed in boilerplate contract language or cost certifications on contracts applying the Safe Harbor indirect cost rate.

The FHWA Division Office will serve as the primary point of contact and liaison for the contracting agency. The FHWA Division Offices also will monitor the respective contracting agency's use of the Safe Harbor indirect cost rate in accordance with the approved, written risk-based oversight procedures.

## **REQUEST FOR COMMENT**

Federal regulations require contracting agencies to provide reasonable assurance to the FHWA that consultant costs on contracts reimbursed with FAHP funding are allowable in accordance with the Federal cost principles. The FHWA is seeking public comment on expanding the use of the Safe Harbor indirect cost rate, beyond the 10 pilot States, to allow other interested contracting agencies to use a self-administered Safe

Harbor Program, under a risk-based approach compliant with 23 CFR 172.11(c), to provide that reasonable assurance. A self-administered Safe Harbor Program would involve, but not be limited to, the following:

- (1) A contracting agency developed risk-based analysis compliant with 23 CFR 172.11(c)(2);
- (2) Written policies and procedures (Work Plan) consistent with the pilot program detailed above; and
- (3) Approval from the FHWA Division Office in the relevant State.

The workplan used in the test evaluation has been posted on the docket as an example of the elements that should be included in a risk-based oversight procedure submitted to FHWA for approval.

Commenters are encouraged to address any or all the areas listed above. The FHWA encourages commenters to submit any information or data demonstrating the benefits, costs, and cost-savings of this program. For example, FHWA would be interested in receiving quantifiable estimates of the burden associated with the annual development of an indirect cost rate, hiring a CPA to conduct necessary audits, and any other costs that would be avoided by a consulting firm or contracting agency in utilizing this Safe Harbor indirect cost rate. Commenters are also encouraged to focus on matters within the control of FHWA. The FHWA will consider public comment before adopting its final guidance on the application of a Safe Harbor indirect cost rate under a risk-based stewardship approach.

**Authority:** 23 U.S.C. 112, 145 and 315; 23 CFR 1.32, and 172; 49 CFR 1.85.

Issued on: July 9, 2018.

Brandye L. Hendrickson,  
Acting Administrator,  
Federal Highway Administration.

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